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No. 31

In the Supreme Court of the United States

OCTOBER TERM, 1930

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SANFORD & BROOKS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 20–25) is reported in 35 F. (2d) 312. The opinion of the Board of Tax Appeals (R. 8–14) is reported in 11 B. T. A. 452.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 28) was entered October 18, 1929. The petition for a writ of certiorari was filed January 16, 1930, and was granted March 3, 1930 (R. 29–30), 281 U. S. 707. The jurisdiction of this Court rests

on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the amount of a judgment against the United States recovered and collected by the taxpayer in 1920, in a sum equal to the amount by which expenditures made during the years 1913 to 1916, in the performance of a contract, exceeded the compensation received under the contract in those years, should be included in a taxpayer's gross income for the year 1920.

STATUTES INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra* pp. 27–33.

STATEMENT

The record does not include the evidence. The essential facts were found by the Board of Tax Appeals. (R. 8–9.) The following is a verbatim copy with a few unimportant omissions. In the matter quoted, "petitioner" refers to the corporation which is the respondent in this Court. (R. 2.)

> In 1912 the Atlantic Dredging Company entered into a contract with the United States Government to dredge a part of the Delaware River. During the years 1913, 1914, and 1915, the petitioner, as agent for the Atlantic Dredging Company, was engaged in carrying on the work under the contract. In December, 1915, after having

operated at a loss under the contract to this time, the petitioner refused to proceed with the contract and subsequently, in 1916, brought suit in the Court of Claims against the United States to recover an amount of $545,121.72 in addition to the amount which had been paid it on the basis of the unit prices set out in the original contract and a supplemental contract later entered into. This suit was brought in the name of "Atlantic Dredging Company, W. E. Brooks, Agent." The basis on which recovery was sought was the failure on the part of the United States to make a proper disclosure in its specification of the character of the material to be dredged.

June 3, 1918, the Court of Claims decided that the Atlantic Dredging Company was entitled to recover the sum of $211,050.09 and entered judgment for that amount. *Atlantic Dredging Company* v. *United States,* 53 Ct. Cls. 490.

Upon appeal to the Supreme Court of the United States, this judgment was affirmed in a decision rendered April 26, 1920. *United States* v. *Atlantic Dredging Company, W. B. Brooks, Agent,* 253 U. S. 1.

The amount of the judgment, $211,050.09, together with interest of $16,305.71, or a total of $227,355.80, was paid in 1920. Of this amount the Atlantic Dredging Company received $34,778.21 and the petitioner $192,577.59. The latter amount included interest in the amount of $16,305.71, and left a balance of $176,271.88, which the peti-

tioner received under the judgment on account of work which it had performed.

The petitioner actually expended in the prosecution of the work the sum of $354,009.19. Prior to the recovery under the judgment of the Court petitioner had received from the Government on account of the work in question the sum of $142,959.10, making a difference between the amount expended and the amount received of $211,050.09, the amount recovered in the judgment. The part of this excess of expenditures over payments received, $176,271.88, which was applicable to the petitioner, related to the years 1913 to 1916 on the basis of the excess of expenditures over receipts in these years as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	176,271.88

The United States did not at any time prior to 1920 admit or recognize any liability to petitioner in addition to the amount set forth in the contract, nor did petitioner have the claim which formed the basis of the judgment on its books as an asset on account of a debt due from the United States until payment was received in 1920.

The excess of expenditures made over payments received from the contract in question served to decrease the income reported for the years 1913 to 1916. These returns showed losses for 1913, 1915, and 1916, and net income for 1914.

> The Commissioner held that the entire amount of the judgment was income in 1920, whereas the petitioner did not report any of it as income in 1920, but filed amended returns asking that it be treated as income in the years 1913 to 1916, inclusive.

The taxpayer appealed from the determination of the Commissioner to the Board of Tax Appeals. The Board rendered its decision on April 10, 1928, upholding the determination of the Commissioner, with three members dissenting. (R. 15.) From this decision the taxpayer appealed to the Circuit Court of Appeals for the Fourth Circuit. (R. 16.) That court, with one judge dissenting, reversed the decision of the Board of Tax Appeals, holding that the amount collected under the judgment in question constituted reimbursement of losses sustained under the contract and was not taxable income. It remanded the case with directions that, upon the filing of amended returns for 1913 to 1916, eliminating the deductions claimed on account of the loss, which has been reimbursed, the amount received in reimbursement should be excluded in the computation of taxable income for the year 1920. (R. 20–28.)

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred—

1. In holding that the amount collected in 1920 under the judgment against the United States should be excluded from the taxpayer's gross income for that year.

2. In considering and deciding questions directly affecting tax liability for the years 1913 to 1916, when such taxable years were not involved in taxpayer's petition to the Board of Tax Appeals.

3. In holding that by virtue of a judgment against the United States in 1920 the taxpayer's returns for 1913 to 1916, inclusive, may now be amended by eliminating therefrom the deductions claimed for expenditures under its contract with the Government to the extent that such deductions exceed the amount received under the contract.

SUMMARY OF ARGUMENT

I

The sum received in satisfaction of the judgment against the United States was properly a part of the taxpayer's gross income. The term "gross income," as defined in Section 213 (a) of the Revenue Act of 1918, includes "gains, profits and income derived from * * * trades, businesses * * * or the transaction of any business carried on for gain or profit." The amount paid in satisfaction of the judgment was recovered as the result of a transaction for dredging the Delaware River, a transaction entered into for profit, and was simply compensatory for work done. The fact that there was no net profit in the transaction is immaterial. The statute contemplates the inclusion in gross income of all receipts from business transactions and the deductions of all expenses incurred in connection therewith.

II

The respondent is not entitled to have the income in question computed on the method of long-term contracts provided in the regulations. Certain regulations of the Bureau of Internal Revenue do give contracting concerns certain options peculiar to long-term contracts, but the statute does not allow a taxpayer to make his return in accordance with these options unless its books are kept on that basis. The record here does not indicate that the taxpayer's books were kept on the basis of long-term contracts. Moreover, the taxpayer has never asserted the right to have its income computed according to the long-term contract method.

III

In the absence of a showing whether the respondent's return for 1920 was made on the cash or on the accrual basis, the Commissioner's determination should not be reversed unless it was correct on neither basis.

IV

The amount received in satisfaction of the judgment was taxable in 1920 on the cash basis as an amount actually received within that year.

V

The amount received in satisfaction of the judgment was taxable in 1920 on the accrual basis as an

amount accrued within that year. Liability on the respondent's claim was disputed and was doubtful until the decision of this Court in 1920. The amount received by the taxpayer consequently did not accrue until the judgment was obtained. This rule has been established by decisions of this Court in cases involving the question when a taxpayer may deduct as an expenditure the amount of a judgment, and we contend that the corresponding rule should be applied to the accrual of gross income.

VI

The decision of the court below is erroneous because it was based on an essential condition which that court had no authority to impose. Although this condition is in favor of the United States, we urge that it is not a proper one, and that the very fact of its inclusion in the decision of the Circuit Court of Appeals shows that that decision was erroneous.

ARGUMENT

I

THE SUM RECEIVED IN SATISFACTION OF THE JUDGMENT AGAINST THE UNITED STATES WAS PROPERLY A PART OF THE TAXPAYER'S GROSS INCOME

The Circuit Court of Appeals apparently held that the sum received in satisfaction of the judgment against the United States was not part of the respondent's income because it constituted simply a "reimbursement of loss." It would seem to be a necessary basis for this decision that the term

"gross income" as used in the Revenue Act relates only to profits, and that where a transaction does not result in a profit any amount received at the termination of the transaction represents recoupment of the expenses and should not, therefore, be included in gross income. We submit that there is no proper basis for this proposition, and that the sum received in satisfaction of the judgment was properly a part of the respondent's gross income.

The term "gross income" is defined in Section 213 (a) of the Revenue Act of 1918 (*infra,* pp. 27–28). This section provides that the term "gross income"—

> Includes gains, profits, and income derived from * * * professions, vocations, trades, businesses, * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

The contract for dredging the Delaware River was a transaction entered into for profit. The amounts received from the Government in the years 1913 to 1916 as payments under the express contract were unquestionably income, and apparently were treated as such by the taxpayer in its returns for those years. The amount paid in satisfaction of the judgment as the result of the decision of this Court is not of a different character from the amounts paid directly under the contract. Both were of the nature of compensation for work per-

formed. In its opinion in *United States* v. *Atlantic Dredging Co.*, 253 U. S. 1, affirming the judgment the proceeds of which are now in question, this Court said (p. 12):

> The Government makes the point, however, that the implication of the case is that bad methods were used, and insists that the implication makes the action one for a tort, and not tenable against the United States. We can not assent. There is no intimation of bad faith against the officers of the Government and the Court of Claims regarded the representation of the character of the material as the nature of a warranty; besides, its judgment is in no way punitive. It is simply compensatory of the cost of the work, of which the Government got the benefit.

Since the tax is levied and collected not on profits but on the "net income" of the annual period, the fact that there was no net profit in this transaction is immaterial in determining whether or not the amount of the judgment should be included in gross income. The amount of taxable net income, if any, depends upon the combined result of all of the taxpayer's operations for the taxable period, ascertained in the manner prescribed in the Revenue Act. Thus, Section 234 of the Revenue Act of 1918 (*infra*, pp 28–29) allows as deductions "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" as well as certain interest, taxes paid,

and allowances for depreciation. The taxpayer did take such deductions in its returns for the years 1913 to 1916, inclusive. If the statute contemplated that the taxpayer should include in its gross income only that part of its receipts, if any, which represented profits, there would have been no provision for the allowance of ordinary and necessary expenses and other deductions. These provisions make it clear that all receipts from ordinary business transactions are to be included in gross income and that the net income for any particular year is to be computed by deducting from those gross receipts the expenses and other deductions authorized by statute.

The fact that the judgment was against the Government and payment was made by the Government does not affect the case. It is not different, so far as the computation of the tax is concerned, from a judgment under a contract with a private person.

The taxpayer, although now contending that the money received under the judgment is not income at all, reported it as income for the years 1913, 1914, 1915, and 1916 in its amended returns filed after the receipt of the money, and its petition to the Board admits that it must in some way account for this as income. (R. 3–4.)

Although the Circuit Court of Appeals states that the money in question "is not income" (R. 22), its decision in effect requires it to be treated as income for the earlier years. That court relied

upon *Eisner* v. *Macomber*, 252 U. S. 189, and *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170.

We submit that nothing was decided in either of those cases which conflicts with our contentions. In the former case this Court held that Congress was not empowered by the Sixteenth Amendment to tax stock dividends as income. The definition of income (252 U. S. at p. 207) was formulated in order to distinguish income from capital and throws little, if any, light upon the instant problem.

In the latter case the taxpayer borrowed German marks before the War, and afterwards paid them back by the expenditure of a comparatively small sum on account of the change in the rates of exchange. It appeared that the taxpayer had lent all of the money which it borrowed to a subsidiary, of which it owned all of the stock, and that this subsidiary had lost all of the amounts advanced to it in business transactions. This Court held that the difference between the value of marks measured by dollars at the time of payment and the value when the loans were made to the taxpayer was not income. It said (p. 175):

> The transaction here in question did not result in gain from capital and labor, or from either of them, or in profit gained through the sale or conversion of capital. The essential facts set forth in the complaint are the loans in 1911, 1912, and 1913, the loss in 1913 to 1918 of the moneys borrowed, the excess of such losses over income by more than the item here in controversy,

> and the payment in the equivalent of marks greatly depreciated in value. The result of the whole transaction was a loss.
>
> * * * * *
>
> The contention that the item in question is cash gain disregards the fact that the borrowed money was lost, and that the excess of such loss over income was more than the amount borrowed. When the loans were made and notes given, the assets and liabilities of defendant in error were increased alike. The loss of the money borrowed wiped out the increase of assets, but the liability remained. The assets were further diminished by payment of the debt. The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit, or income.

But in the instant case the amount received under the judgment did result from work performed as part of a transaction entered into for profit, and it thus falls within the definition of gross income in the Revenue Act.

II

THE RESPONDENT IS NOT ENTITLED TO HAVE THE INCOME IN QUESTION COMPUTED ON THE METHOD OF LONG-TERM CONTRACTS PROVIDED IN THE REGULATIONS

The Circuit Court of Appeals, in its opinion (R. 22–23), quotes and relies on certain regulations of the Bureau of Internal Revenue relating to long-term contracts. These regulations are set out in the

Appendix, *infra*, pp. 31–33. They provide that in reporting the income derived from certain long-term contracts the taxpayer may (a) report all of the receipts and all of the expenditures made on account of a particular contract in the year in which the work is completed, or (b) report each year the percentage of the estimated profit on the basis of the percentage of expenditures.

These regulations must, of course, be read in the light of the statute under which they were promulgated. Section 212 (b) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064–1065, which was the Act in force during the calendar year 1920, provided that—

> The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income.

The provisions of Article 36 of Regulations 45, relating to long term contracts merely embody the recognition of the Commissioner that when a taxpayer's books are kept on the basis of long-term contracts, that basis does clearly reflect income, and may be used in reporting the taxpayer's income. But there is nothing in this regulation which allows a taxpayer to make his return on the long term

contract basis unless his books are kept on that basis. And, indeed, if the regulation had so provided, it would seem to be in conflict with the express provisions of the statute, which required that the computation "shall be * * * in accordance with the method of accounting regularly employed in keeping the books" of the taxpayer, unless that method does not clearly reflect income.

The record does not indicate that the taxpayer's books for the year 1920 were kept on the basis of long-term contracts. It is accordingly in no position to contend that its income for 1920 should be returned on that basis. Nor does the record furnish any basis for the return of this income on the long term contract basis for any other year.

The taxpayer has never asserted the right to have its income computed on the long-term contract basis. It does not appear that it prepared any of its returns upon that basis. Neither in its petition to the Board (R. 2–5) nor in its petition for review filed in the Circuit Court of Appeals (R. 16–18) did it assert the right to have the income computed upon this basis. It did not rely upon or mention the regulations in question either in the hearing before the Board or before the Circuit Court of Appeals.

Furthermore, where there are two methods of making an income-tax return, either one of which is legal and proper, and the taxpayer has made his return in accordance with one of these methods,

the taxpayer can not subsequently change to the other method and thereby become entitled to a refund. *Le Bolt & Co.* v. *United States*, 67 C. Cls. 422. And, we submit, in the absence of any action on the part of the taxpayer, it is not proper for the court to compute the income upon a basis different from that which the taxpayer has selected.

In any event it is clear that the taxpayer has not complied with the conditions upon which the regulations permit the use of the long-term contract method. Under the first of the two options indicated by these regulations, all income and deductions are deferred until the contract is completed. Here it is clear that the taxpayer did not defer reporting all these items. The record indicates that both receipts and disbursements on account of this contract were reported in the returns for the years 1913 to 1916. (R. 3, 9.) Under the second of the options allowed by the regulations, the taxpayer is required to make an estimate of the percentage of profit and a computation of income each year upon the basis of that part of the estimated expenses incurred during the year. It does not appear that this taxpayer ever made such an estimate or attempted to report its income and deductions on that basis. Moreover, the regulations providing for this option require that the taxpayer file amended returns upon the completion of the contract in case the estimates have been incorrect. Here it appears that the taxpayer stopped work

on the contract in 1915 (R. 8), but it did not then attempt to file any amended returns and did nothing about the matter until 1920 when it received the amount of the judgment. (See R. 4.)

III

IN THE ABSENCE OF A SHOWING WHETHER THE RESPONDENT'S RETURN FOR 1920 WAS MADE ON THE CASH OR ON THE ACCRUAL BASIS, THE COMMISSIONER'S DETERMINATION SHOULD NOT BE REVERSED UNLESS IT WAS CORRECT ON NEITHER BASIS

The Board of Tax Appeals made no finding as to the basis upon which the taxpayer filed its return for 1920 and the record does not show whether this return was filed on a cash receipts and disbursements basis or on an accrual basis.[1] Consequently the Commissioner's determination was properly approved by the Board if his action was justified either on the assumption that the taxpayer's return was made on the cash basis or on the assumption that it was made on the accrual basis. In a suit to recover a tax the determination of the Commissioner is *prima facie* correct. *Wickwire* v. *Reinecke*, 275 U. S. 101; *United States* v. *Rind-*

[1] The taxpayer filed as an exhibit to its petition before the Board of Tax Appeals a letter from the Commissioner of Internal Revenue and a statement which accompanied the letter. (R. 5–6.) In this statement the following language was used (R. 6): "You are advised that the bureau holds that the income from a judgment accrues to the taxpayer when a final determination has been made." But we do not believe that any significance can be attached to this language in the absence of any finding by the Board of Tax Appeals.

skopf, 105 U. S. 418. The burden rests upon the taxpayer to prove all the facts necessary to establish the illegality of the Commissioner's determination. *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357,361; *Botany Mills* v. *United States*, 278 U. S. 282; *Reinecke* v. *Spalding*, 280 U. S. 227. The rule is the same in an appeal to the Board. *Avery* v. *Commissioner*, 22 F. (2d) 6 (C. C. A. 5th); *Austin Co.* v. *Commissioner*, 35 F. (2d) 910 (C. C. A. 6th). Since the taxpayer has not shown upon what basis its return was filed, it can not prevail if the Commissioner's action was justified on either basis.

IV

THE AMOUNT RECEIVED IN SATISFACTION OF THE JUDGMENT WAS TAXABLE IN 1920 ON THE CASH BASIS AS AN AMOUNT RECEIVED WITHIN THAT YEAR

The findings of the Board of Tax Appeals show that the amount of the judgment was paid in 1920. (R. 9.) Section 213 (a) of the Revenue Act of 1918 (*infra*, pp. 27–28) provides that—

> The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

This section requires that the items of gross income shall be reported for the year in which re-

ceived, when the taxpayer's return is made on the basis of cash receipts and disbursements. It is well settled that compensation for services rendered or work done must be reported as gross income for the year in which received, regardless of the year in which the work was performed. *Edwards* v. *Keith,* 231 Fed. 110 (C. C. A. 2d); *Woods* v. *Lewellyn,* 252 Fed. 106 (C. C. A. 3d); *Jackson* v. *Smietanka,* 272 Fed. 970 (C. C. A. 7th).

V

THE AMOUNT RECEIVED IN SATISFACTION OF THE JUDGMENT WAS TAXABLE IN 1920 ON THE ACCRUAL BASIS AS AN AMOUNT ACCRUED WITHIN THAT YEAR

If the taxpayer's return for 1920 was made on the accrual basis, the sum in question accrued in 1920 and should have been returned by the taxpayer in that year. The judgment of this Court affirming the judgment of the Court of Claims in favor of the taxpayer was entered on April 26, 1920. (R. 9.) The liability of the United States upon the respondent's claim was not established until the decision of this Court in 1920. Until then the Government contested liability and maintained this position until the decision of this Court to the contrary. Until that time both the question of liability and the question of the amount recoverable were uncertain. It is significant that two of the five judges of the Court of Claims and two of the Justices of this Court dissented from the

decision that there should be a recovery. The plaintiff in the Court of Claims sued for an amount greatly in excess of that which was ultimately recovered. (See pp. 2–3, *supra.*) There was considerable doubt as to the legal basis for recovery. See dissenting opinion of Campbell, C. J., 53 C. Cls. 490, 505. Regardless of the basis for recovery, the income did not accrue until after the disputes as to liability and as to damages were settled. This would be true if, as indicated by this Court, the recovery was for breach of warranty and in the nature of compensation for work performed, and *a fortiori* it would be true on the basis apparently taken by the Court of Claims (53 C. Cls. 490, 504), that the recovery was for damages caused by the misrepresentation by officers of the United States.

In *Lucas* v. *American Code Co.*, 280 U. S. 445, this Court decided that an expense, on account of damages for discharge of an employee, which was not finally established until the entry of a judgment did not accrue until the year in which the judgment was entered. The Court said (p. 449):

> Generally speaking, the income tax law is concerned only with realized losses, as with realized gains. *Weiss* v. *Wiener*, 279 U. S. 333, 335. Exception is made, however, in the case of losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduction, in certain circumstances, before they are absolutely real-

> ized. As respects losses occasioned by the taxpayer's breach of contract, no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test.

See also *Columbus Plate & Window Glass Co.* v. *Miller,* 38 F. (2d) 509 (S. D. Ohio). Although these cases related to deductions we see no reason why the rule is not equally applicable to the question of when an item of gross income accrues.

A similar case is *Lewellyn* v. *Electric Reduction Co.,* 275 U. S. 243. In that case the taxpayer in 1918 contracted to purchase tungsten ore and paid a draft which was to be applied against the purchase price of the first carload of ore shipped. Only a small quantity of ore was ever shipped. A balance was due the taxpayer of more than $27,000, to recover which suits were instituted by the taxpayer in 1919. The suits were terminated in 1922 without any recovery by the taxpayer. It thereupon filed an amended income-tax return for 1918, claiming the $27,000 as a loss in 1918. This Court held that the loss could not be deducted in that year, since it did not become certain that there would be a loss until the litigation was terminated in 1922. See *Highland Milk Condensing Co.* v. *Phillips,* 34 F. (2d) 777 (C. C. A. 3d), certiorari denied, 280 U. S. 608. See also *United States* v. *White Dental Co.,* 274 U. S. 398; *Lucas* v. *Ox Fibre Brush Co.,* 281

U. S. 115. Conversely, we submit, an item of gross income which is contested, and which is not finally determined until the entry of a judgment, does not accrue until the judgment is entered—at least if there is serious doubt as to whether the amount will be recovered.

A practical objection to the allocation to prior years of income later acquired through the entry of a judgment after litigation is the question of limitations. The final determination of compensation in cases similar to the instant case might well be delayed until after the statute of limitations has run as to the collection of the tax for the year to which the income would be allocated if it should be held that the income accrued in the years in which the work was performed. The only way in which the statutory limitation could be avoided would be by advance assessments based on guesswork, which are not authorized by statute.

The following language of the dissenting opinion in the court below seems to us convincing (R. 27):

> * * * Let it be supposed that the petitioner instead of losing during the four years involved, and recovering in the one year, had lost in one year, and had recovered on doubtful claims in four different years subsequently, certainly upon recovery in each of the four years the Government could not be required to go back and reform the tax assessment for the one year in which the loss was incurred, or four different times. To hold this would be to hold that the assess-

ment of taxes by the Government would never be completed for any given year, and would bring about a situation that would be chaotic.

* * * * *

The fact, that the losses were made and reported over a period of four years and the recovery had in one year worked to the financial disadvantage of the petitioner, is merely an incident. It might have worked to his advantage. In any event, the whole tax collection system of the Government can not be upset or changed to meet the exigencies of a particular case. One rule must be laid down for all, and Congress has seen fit to lay down the rule that the year is the unit, and we can see no reason for disregarding the rule.

VI

THE DECISION OF THE COURT BELOW IS ERRONEOUS BECAUSE IT WAS BASED UPON AN ESSENTIAL CONDITION WHICH THAT COURT HAD NO AUTHORITY TO IMPOSE

The Circuit Court of Appeals ordered that the amount received under the judgment should be eliminated from the computation of taxable income for the year 1920 upon condition that the taxpayer file amended returns for the years 1913 to 1916, eliminating the deductions claimed on account of the loss which was reimbursed. We maintain that the Circuit Court of Appeals had no authority to consider and determine any question directly affecting the taxpayer's liability for the years 1913 to 1916. The Board of Tax Appeals has jurisdic-

tion only as to years in which the Commissioner has determined a deficiency. Section 274 (g) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 56, provides:

> The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

See *Wolf Mfg. Co.* v. *Commissioner*, 10 B. T. A. 1161; *Blackstone* v. *Commissioner*, 12 B. T. A. 456.[2] The Board accordingly entered no order of redetermination as to the years 1913 to 1916, for the reason, among others, that it had no power to do so. (R. 14.) The jurisdiction of the Circuit Court of Appeals on the petition to review the decision of the Board of Tax Appeals can hardly be broader than the jurisdiction of the Board,[3] and consequently the

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[2] Before the passage of the Revenue Act of 1926 the Board did have jurisdiction as to years for which the Commissioner had determined no deficiency. *Appeal of E. J. Barry*, 1 B. T. A. 156; *Appeal of Hickory Spinning Co.*, 1 B. T. A. 409. See *Blair* v. *Oesterlein Machine Co.*, 275 U. S. 220, 225. But this jurisdiction was taken away by the Revenue Act of 1926, and the limitations of that Act applied to appeals which were filed before its passage. *Appeal of Cornelius Cotton Mills*, 4 B. T. A. 255; *Appeal of W. H. Morefield*, 4 B. T. A. 394.

[3] See Section 1003 of the Revenue Act of 1926, pp. 30–31, *infra*.

Circuit Court of Appeals had no power to order the filing of amended returns as to the years 1913 to 1916. Since this order was an essential part of the judgment below, we contend that that judgment can not stand.

We recognize, of course, that the condition which was imposed in the judgment of the Circuit Court of Appeals is in favor of the Government, but we urge that the condition is not a proper one, and that the very fact of its inclusion in the decision of the Circuit Court of Appeals shows that that decision was erroneous.

But if we are in error as to the question of the jurisdiction of the Circuit Court of Appeals over the years 1913 to 1916, nevertheless that court's adjustment for those years can be justified only on the theory that the amount of the judgment accrued in those years. The loss on the contract which the returns for those years deducted arose because of the fact that the expenses incurred under the contracts exceeded the amount received. If, therefore, these losses—an excess of expenditures over receipts— are to be eliminated, it can only be on the theory that there is additional income to apply against them. The amount of the judgment was obviously not income actually received until 1920. It follows, therefore, that if it is to be applied against the expenditures incurred during 1913 to 1916 as it has been under the decision of the Circuit Court of Appeals, it must be treated as

income which accrued during those years. But, as we have contended above the amount realized on the judgment did not accrue until 1920, in which year the liability was determined and the judgment was entered; nor is there anything in the record to show that this taxpayer made its return on an accrual basis in the years in question. The decision of the Circuit Court of Appeals is, therefore, we submit, erroneous.

CONCLUSION

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
CLAUDE R. BRANCH,
SEWALL KEY,
ANDREW D. SHARPE,
Special Assistants to the Attorney General.
ERWIN N. GRISWOLD,
Attorney.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
PREW SAVOY,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

NOVEMBER, 1930.

APPENDIX

STATUTES

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064, 1065, 1077, provides in part:

TITLE II.—INCOME TAX

* * * * *

PART II.—INDIVIDUALS

* * * * *

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, busi-

nesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period * * *.

PART III.—CORPORATIONS

* * * * *

SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213 * * *.

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services

actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income * * *;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

[The extracts of subparagraphs (2), (3), and (6) given above are by no means complete. All that we have attempted to do is to indicate the general nature of the deductions allowed. Other classes of deductions are also specifically provided for in subparagraphs (8) through (14).]

The Revenue Act of 1926, c. 27, 44 Stat. 9, 55, 56, 110, provides in part:

SEC. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer

may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. * * *

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * *

(g) The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

SEC. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the

judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

REGULATIONS

Article 121 of Regulations 33 (Revised), promulgated January 2, 1918, under the Revenue Acts of 1916 and 1917, provided as follows:

ART. 121. *Contracting corporations.*—Corporations engaged in contracting operations and which have numerous uncompleted contracts, which in some cases run for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work—that is, on jobs which have been finally completed—any and all moneys received in payment for completed jobs will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts.

Income on basis of estimates.—Or the percentage of profit from the contract may be estimated on the basis of percentage of completion and payments made thereon, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the ex-

penses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year; all under or over statements of income to be adjusted upon completion of the contract and return made accordingly. (T. D. 2161.)

In cases wherein contracts are fully performed in one year, although payment therefor may be deferred until the next, the income resulting from the performance of the contract shall be returned for the year in which it was actually earned and determined.

Article 36 of Regulations 45, promulgated April 19, 1919, under the Revenue Act of 1918, provided:

ART. 36. *Long-term contracts.*—Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from such gross income should include and be limited to the expenditures made on account of such completed contracts. Or the percentage of profit from the contract may be estimated on the basis of percentage of expenditures, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that

is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. Upon the completion of a contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer must file amended returns for such year or years. See section 212 of the statute and articles 22–24.

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